

ORIGINAL

OPEN MEETING



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MEMORANDUM

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TO: THE COMMISSION

2005 DEC 23 A 10: 25

FROM: Utilities Division

AZ CORP COMMISSION  
DOCUMENT CONTROL

DATE: December 23, 2005

RE: IN THE MATTER OF THE PURCHASED POWER AND FUEL ADJUSTMENT  
THRESHOLD LEVEL FOR THE MORENCI WATER & ELECTRIC COMPANY  
(DOCKET NO. E-01049A-04-0936)

In Decision No. 67676 (March 9, 2005), the Commission approved a temporary reduction of \$0.02939 per kWh in the Purchased Power and Fuel Adjustment Clause ("PPFAC" or "adjustor") rate for The Morenci Water & Electric Company ("Morenci" or "the Company"). In that Decision, the Commission also ordered, "Staff shall, by December 31, 2005, file with the Commission a recommendation establishing a threshold over/under collected (trigger) bank balance for Morenci Water and Electric Company's Purchased Power and Fuel Adjustment Clause."

An important point in considering the threshold level to set is to recognize that, by nature, such a level is somewhat arbitrary and that the intent is to trigger some type of action by the Company to come to the Commission to address the bank balance when it reaches or exceeds a designated level. The purpose of such action is to preclude the possibility of enormous growth in the bank balance without consideration of any substantive action to address it. Another consideration is that the level of the threshold should strive to be a reasonable compromise balancing the need to possibly come to the Commission and take action to address an excessive bank balance with an attempt to avoid having to come to the Commission more often than is necessary. Another important point in considering the threshold level is that reaching that given level does not necessarily result in any PPFAC rate change or other specific action being taken by the Commission. The threshold simply serves as a review point to highlight that the bank balance is becoming relatively large, and that the Company should come to the Commission in some manner to address it. The Commission may or may not choose to act on it at that time.

Morenci currently does not have a threshold level associated with its PPFAC. Staff has had several conversations with the Company about the implementation of a bank balance threshold, and the Company has indicated that it regards the concept of establishing a threshold positively. Staff has discussed threshold levels with the Company and has identified similar structures and levels which both parties believe may be appropriate.

Morenci exhibits an atypical distribution of electric sales. Approximately 98 percent of the Company's electric sales are contract sales to its single industrial customer and fall outside

the PPFAC because the customer is served under a special contract. The PPFAC mechanism is relevant only to the other two percent of Morenci's sales to 1,732 residential and 257 commercial customers as of September 2005. During the last three years, the Company's electric sales subject to the PPFAC exhibited a slow and stable growth pattern, but with some seasonality during the summer cooling season and the winter heating season. Although the costs to serve the large industrial customer are not included in the PPFAC, Morenci is able to negotiate long-term contracts for all of its customers because of this large industrial load, resulting in lower prices and added stability in its purchased power costs for all customers.

The Company's PPFAC bank balance has been over-collected since June 2003. From June 2003 through December 2003, the balance grew from \$6,712 to \$164,141. Throughout 2004, the over-collected balance continued to grow to a level of \$475,753. The over-collected balance continued to grow through March 2005, at which time it reached a maximum level of \$557,497. At this time, the temporary reduction of \$0.02939 per kWh ordered in Decision No. 67676 became effective, increasing the Company's negative adjustor from -\$0.01391 to -\$0.04330. The Company's PPFAC bank balance has been declining each month since that time to a level of \$310,177 as of September 2005. See exhibit.

One factor that Staff examined in its consideration of a threshold level is the bank balance per residential customer.<sup>1</sup> As the bank balance became over-collected in mid-2003, the balance per residential customer grew from approximately \$2 in June 2003 to \$48 at the end of 2003. During 2004, the bank balance per residential customer continued to grow to \$129 by the end of the year. During the first quarter of 2005, the bank balance per residential customer climbed to its maximum level of \$144 in January 2005. Beginning in February 2005, it dropped to its current level of \$73. See exhibit. For an over-collected bank balance, Staff is concerned that these levels may represent an excessive amount of money for residential customers to have paid in advance. One possible solution to such a high bank balance per residential customer would be to propose a range that may seem more reasonable, such as \$40 - \$60 per residential customer. Staff analysis has indicated that a balance per residential customer of just under \$50, the approximate mid-point of the range, would be associated with a bank balance of \$200,000.

While it may be more desirable to keep the bank balance per residential customer lower than \$50, the Company's bank balance has experienced movements of as much as \$50,000 per month and has been experiencing typical monthly changes in the \$30,000 through \$40,000 range. This would suggest that growth in the bank balance from zero to a trigger level of \$200,000 could be reached in about six months. This rapid movement in the Company's bank balance could be mitigated, however, by having the Company come to the Commission to establish a new adjuster level closer to the Company's actual costs when its bank balance nears zero.

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<sup>1</sup> This balance is the portion of the bank balance attributable to residential sales divided by the number of residential customers.

Staff believes that it is reasonable that the threshold level should be based to some extent upon the size of the Company. This concept would be more relevant to the under-collected threshold level than it would be to the over-collected threshold level, as a larger company would be better able to carry a higher bank balance than would a smaller company. Because of the Company's high contract industrial sales outside the PPFAC, it should be able to carry an under-collected bank balance significantly higher than another company having a similar level of sales under the PPFAC. Companies that have had trigger levels set under the jurisdiction of the Commission have trigger levels of about three to six percent of current annual sales. Taking the midpoint of this range, 4.5 percent, would suggest that a trigger level of \$3.8 million for Morenci, with annual sales of about \$85 million, would not be unreasonable. Because sales under the PPFAC are only about two percent of Morenci's total sales and because Morenci's sales and costs of purchased power are relatively stable, a trigger level of this magnitude would not be necessary. However, an under-collected trigger level of two to three times the over-collected trigger level should not pose a problem for the Company. Taking the midpoint of this range would suggest an under-collected trigger level of \$500,000.

Staff believes that, given Morenci's particular situation, a non-symmetrical threshold may be appropriate. Taking the issues discussed above into consideration, Staff recommends an over-collected threshold level of \$200,000 and an under-collected threshold level of \$500,000.

Staff is concerned that when the current PPFAC \$0.02939 per kWh credit ordered in Decision No. 67676 expires (either when the bank balance is reduced to zero, or the end of February 2007, whichever occurs first), the Company's PPFAC will revert to the former level, and the bank balance could again begin to accumulate at a rapid rate. Taking this into consideration, Staff recommends that the Company file an application with the Commission to establish a new PPFAC rate either two months prior to the month the bank balance is projected by the Company to reach zero, or by December 31, 2006, whichever occurs first.



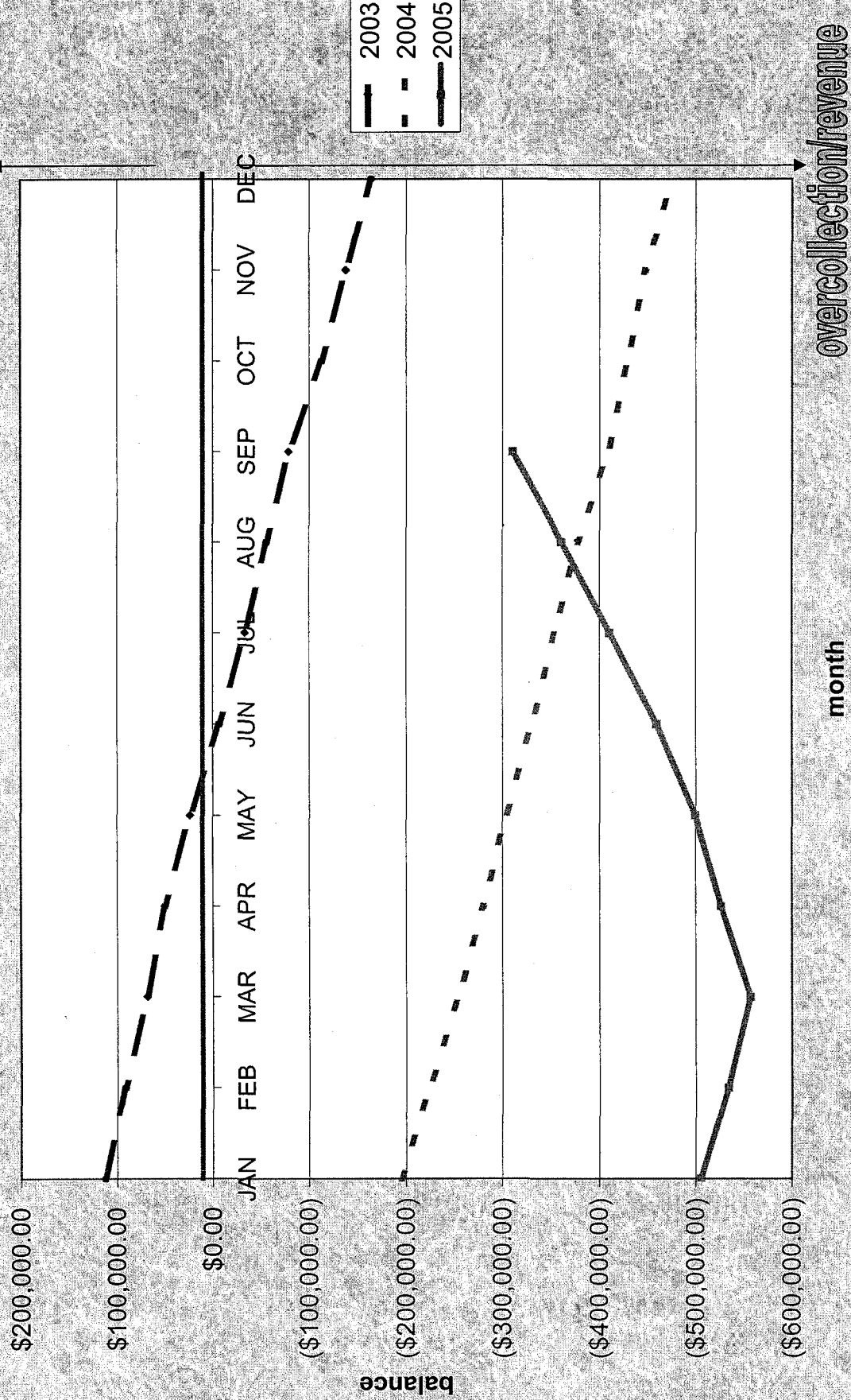
Ernest G. Johnson  
Director  
Utilities Division

EGJ:JDA:lhmd\DR

ORIGINATOR: Jerry D. Anderson

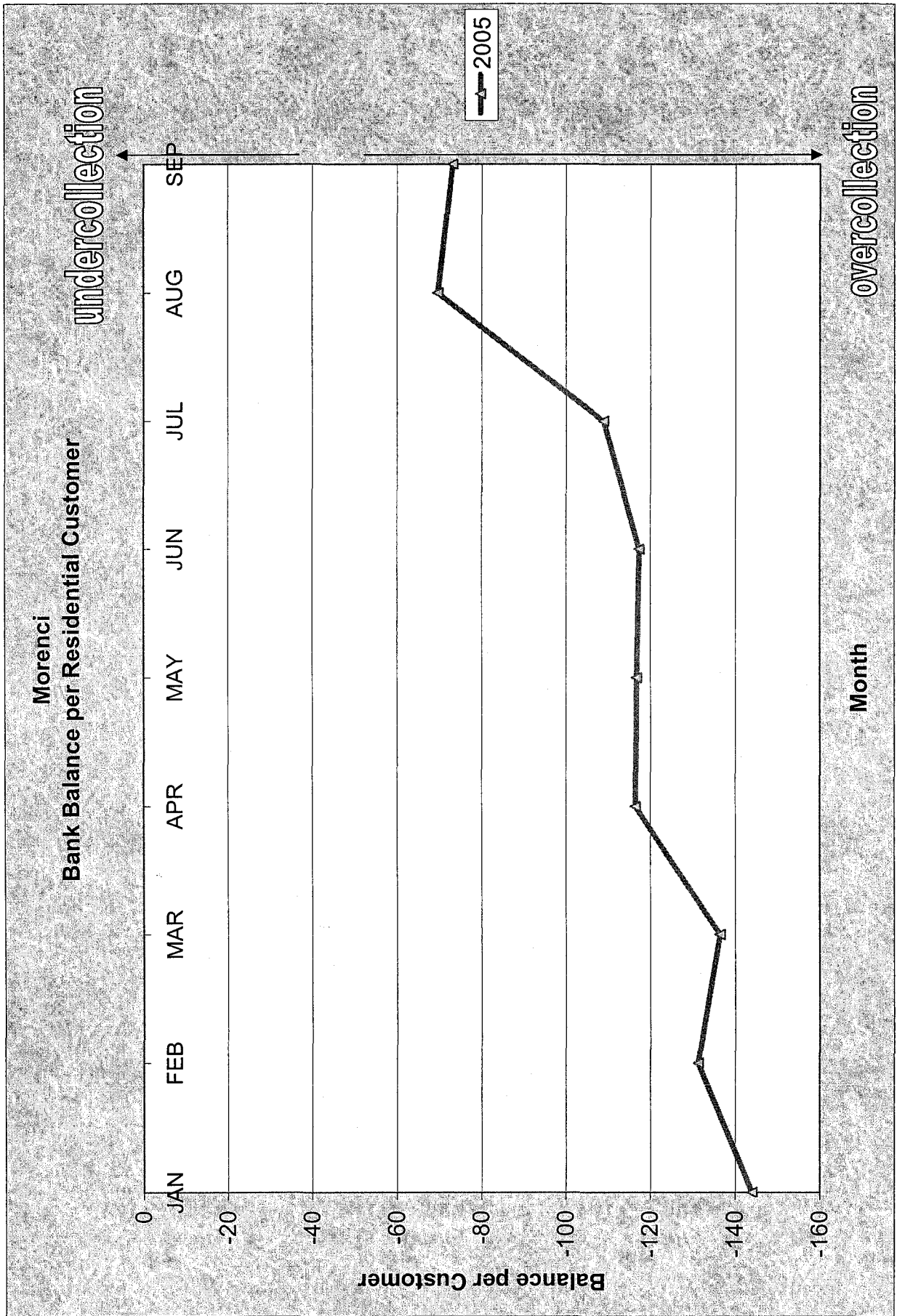
undercollection

Morenci Bank Balance



overcollection/revenue

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**BEFORE THE ARIZONA CORPORATION COMMISSION**

JEFF HATCH-MILLER  
Chairman  
WILLIAM A. MUNDELL  
Commissioner  
MARC SPITZER  
Commissioner  
MIKE GLEASON  
Commissioner  
KRISTIN K. MAYES  
Commissioner

IN THE MATTER OF THE PURCHASED)  
POWER AND FUEL ADJUSTMENT)  
THRESHOLD LEVEL FOR THE MORENCI)  
WATER & ELECTRIC COMPANY )

DOCKET NO. E-01049A-04-0936  
DECISION NO. \_\_\_\_\_  
ORDER

Open Meeting  
January 24 and 25, 2006  
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. The Morenci Water & Electric Company ("Morenci" or "the Company") is certificated to provide electric service as a public service corporation in the State of Arizona.
2. In Decision No. 67676 (March 9, 2005), the Commission approved a temporary reduction of \$0.02939 per kWh in the Purchased Power and Fuel Adjustment Clause ("PPFAC" or "adjustor") rate for Morenci. In that Decision, the Commission also ordered, "Staff shall, by December 31, 2005, file with the Commission a recommendation establishing a threshold over/under collected (trigger) bank balance for Morenci Water and Electric Company's Purchased Power and Fuel Adjustment Clause."
3. An important point in considering the threshold level to set is to recognize that, by nature, such a level is somewhat arbitrary and that the intent is to trigger some type of action by the Company to come to the Commission to address the bank balance when it reaches or exceeds a designated level. The purpose of such action is to preclude the possibility of enormous growth in the bank balance without consideration of any substantive action to address it. Another

1 consideration is that the level of the threshold should strive to be a reasonable compromise  
2 balancing the need to possibly come to the Commission and take action to address an excessive  
3 bank balance with an attempt to avoid having to come to the Commission more often than is  
4 necessary. Another important point in considering the threshold level is that reaching that given  
5 level does not necessarily result in any PPFAC rate change or other specific action being taken by  
6 the Commission. The threshold simply serves as a review point to highlight that the bank balance  
7 is becoming relatively large, and that the Company should come to the Commission in some  
8 manner to address it. The Commission may or may not choose to act on it at that time.

9       4.       Morenci currently does not have a threshold level associated with its PPFAC. Staff  
10 has had several conversations with the Company about the implementation of a bank balance  
11 threshold, and the Company has indicated that it regards the concept of establishing a threshold  
12 positively. Staff has discussed threshold levels with the Company and has identified similar  
13 structures and levels which both parties believe may be appropriate.

14       5.       Morenci exhibits an atypical distribution of electric sales. Approximately 98  
15 percent of the Company's electric sales are contract sales to its single industrial customer and fall  
16 outside the PPFAC because the customer is served under a special contract. The PPFAC  
17 mechanism is relevant only to the other two percent of Morenci's sales to 1,732 residential and  
18 257 commercial customers as of September 2005. During the last three years, the Company's  
19 electric sales subject to the PPFAC exhibited a slow and stable growth pattern, but with some  
20 seasonality during the summer cooling season and the winter heating season. Although the costs  
21 to serve the large industrial customer are not included in the PPFAC, Morenci is able to negotiate  
22 long-term contracts for all of its customers because of this large industrial load, resulting in lower  
23 prices and added stability in its purchased power costs for all customers.

24       6.       The Company's PPFAC bank balance has been over-collected since June 2003.  
25 From June 2003 through December 2003, the balance grew from \$6,712 to \$164,141. Throughout  
26 2004, the over-collected balance continued to grow to a level of \$475,753. The over-collected  
27 balance continued to grow through March 2005, at which time it reached a maximum level of  
28 \$557,497. At this time, the temporary reduction of \$0.02939 per kWh ordered in Decision

No. 67676 became effective, increasing the Company's negative adjustor from -\$0.01391 to -\$0.04330. The Company's PPFAC bank balance has been declining each month since that time to a level of \$310,177 as of September 2005.

7. One factor that Staff examined in its consideration of a threshold level is the bank balance per residential customer.<sup>1</sup> As the bank balance became over-collected in mid-2003, the balance per residential customer grew from approximately \$2 in June 2003 to \$48 at the end of 2003. During 2004, the bank balance per residential customer continued to grow to \$129 by the end of the year. During the first quarter of 2005, the bank balance per residential customer climbed to its maximum level of \$144 in January 2005. Beginning in February 2005, it dropped to its current level of \$73. For an over-collected bank balance, Staff is concerned that these levels may represent an excessive amount of money for residential customers to have paid in advance. One possible solution to such a high bank balance per residential customer would be to propose a range that may seem more reasonable, such as \$40 - \$60 per residential customer. Staff analysis has indicated that a balance per residential customer of just under \$50, the approximate mid-point of the range, would be associated with a bank balance of \$200,000.

8. While it may be more desirable to keep the bank balance per residential customer lower than \$50, the Company's bank balance has experienced movements of as much as \$50,000 per month and has been experiencing typical monthly changes in the \$30,000 through \$40,000 range. This would suggest that growth in the bank balance from zero to a trigger level of \$200,000 could be reached in about six months. This rapid movement in the Company's bank balance could be mitigated, however, by having the Company come to the Commission to establish a new adjuster level closer to the Company's actual costs when its bank balance nears zero.

9. Staff believes that it is reasonable that the threshold level should be based to some extent upon the size of the Company. This concept would be more relevant to the under-collected threshold level than it would be to the over-collected threshold level, as a larger company would be better able to carry a higher bank balance than would a smaller company. Because of the

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<sup>1</sup> This balance is the portion of the bank balance attributable to residential sales divided by the number of residential customers.



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2 collected bank balance significantly higher than another company having a similar level of sales  
3 under the PPFAC. Companies that have had trigger levels set under the jurisdiction of the  
4 Commission have trigger levels of about three to six percent of current annual sales. Taking the  
5 midpoint of this range, 4.5 percent, would suggest that a trigger level of \$3.8 million for Morenci,  
6 with annual sales of about \$85 million, would not be unreasonable. Because sales under the  
7 PPFAC are only about two percent of Morenci's total sales and because Morenci's sales and costs  
8 of purchased power are relatively stable, a trigger level of this magnitude would not be necessary.  
9 However, an under-collected trigger level of two to three times the over-collected trigger level  
10 should not pose a problem for the Company. Taking the midpoint of this range would suggest an  
11 under-collected trigger level of \$500,000.

12 10. Staff believes that, given Morenci's particular situation, a non-symmetrical  
13 threshold may be appropriate. Taking the issues discussed above into consideration, Staff has  
14 recommended an over-collected threshold level of \$200,000 and an under-collected threshold level  
15 of \$500,000.

16 11. Staff is concerned that when the current PPFAC \$0.02939 per kWh credit ordered  
17 in Decision No. 67676 expires (either when the bank balance is reduced to zero, or the end of  
18 February 2007, whichever occurs first), the Company's PPFAC will revert to the former level, and  
19 the bank balance could again begin to accumulate at a rapid rate. Taking this into consideration,  
20 Staff has recommended that the Company file an application with the Commission to establish a  
21 new PPFAC rate either two months prior to the month the bank balance is projected by the  
22 Company to reach zero, or by December 31, 2006, whichever occurs first.

#### 23 CONCLUSIONS OF LAW

24 1. Morenci is certificated to provide electric service as a public service corporation in  
25 the State of Arizona.

26 2. The Commission has jurisdiction over Morenci and over the subject matter of the  
27 application.

28 ...

3. The Commission, having reviewed the application and Staff's Memorandum dated December 23, 2005, concludes that it is in the public interest to approve the Purchased Power and Fuel Adjustment Threshold Level for Morenci.

ORDER

IT IS THEREFORE ORDERED that the PPFAC over-collected threshold level of \$200,000 and the under-collected threshold level of \$500,000 are approved.

IT IS FURTHER ORDERED that the Company file an application with the Commission to establish a new PPFAC rate either two months prior to the month the bank balance is projected by the Company to reach zero, or by December 31, 2006, whichever occurs first.

IT IS FURTHER ORDERED that this decision should become effective immediately.

**BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this \_\_\_\_\_ day of \_\_\_\_\_, 2006.

\_\_\_\_\_  
BRIAN C. McNEIL  
Executive Director

DISSENT: \_\_\_\_\_

DISSENT: \_\_\_\_\_

EGJ:JDA:lhv\DR

Decision No. \_\_\_\_\_

SERVICE LIST FOR: Morenci Water & Electric Company  
DOCKET NO. E-01049A-04-0936

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